ECONOMICS MC TEST: Mon Policy

1. Assume the required reserve ratio is 20%. $200 is moved from a savings account into a checking account. Which is true regarding the money supply?

A. Initially, the money supply has changed its composition but not its size.
B. Eventually, the money supply will increase by $1,000.
C. Initially, M2 has increased by $200.
D. Eventually, the money supply will decrease by $800.
E. Initially, the money supply has increased by $40.

2. Which of the following will most likely occur in an economy if more money is demanded than is supplied?

A. Investment spending will increase.
B. Interest Rates will decrease
C. Interest rates will increase
D. The demand for money will shift left.
E. Demand for money will shift right.

3. An expansionary monetary policy may lead to long-run economic growth if it leads to

A an increase in consumption
B an increase in investment
C a decrease in net exports
D a decrease in loanable funds
E an increase in government spending

4. The long term effects of a change in the M1 money supply on nominal GDP will likely be more unpredictable than a change in the M2 money supply. This is because

A M2 only affects the price level while M1 affects output and price level.
B there is no effective way to measure the impact of M1 like there is for M2.
C in the long run M1 will only have an impact on price, not quantity.
D M1 will tamper with interest rates whereas M2 holds interest rates constant.
E the velocity of M1 is more varied than M2.

5. A recent headline read: "Banks To Pay Larger Interest Rates On Checking Accounts than Savings Accounts". Assuming people act rationally, how will this headline MOST LIKELY affect the money supply?

A M1 will decrease while M2 and M3 will increase.
B There will be no change in the money supply because the FED controls the money supply.
C M2 will remain constant while M1 will increase.
D T-accounts in banks will reflect fewer liabilities and more assets.
M1 and M2 will increase by equal amountsa

6. Which correctly describes the relationship between the discount rate and the federal funds rate?

A. The federal funds rate dictates whether the discount rate should be raised or lowered.
B. There is only a theoretical relationship between the two but no practical cause and effect.
C. The loanable funds market drives both the discount rate and the federal funds rate.
D. When banks are in desperate need of loans, they use a discount rate to borrow from other banks cheaper than the typical federal funds rate.
E. The Federal Reserve Bank uses the discount rate as a signal to what they would like the federal funds rate to be.

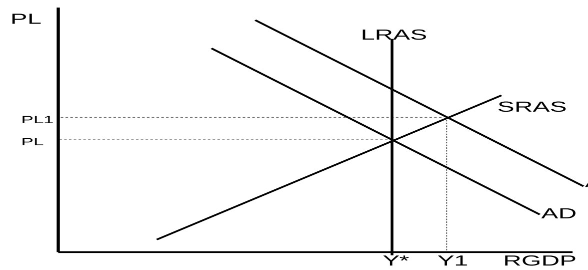
7. If on receiving a checking deposit of $300 a bank's excess reserves increased by $255, the required reserve ratio must be

A. 5%
B. 15%
C. 25%
D. 35%
E. 45%

8. The Federal Reserve can increase the Money Supply by

A. Selling gold reserves to the banks.
B. selling foreign currency holdings.
C. buying government bonds on the open market.
D. selling government bonds on the open market.
E. borrowing reserves from foreign governments.

Use the following graph to answer question #9:



9. Assuming the effects of the graph above were caused by one-time fiscal policy and no further government or Fed actions are taken, which correctly explains how the economy will self-correct in the long run?

A The higher price level will encourage more production and SRAS will shift left.
B The economy will overheat until LRAS is stimulated to increase.
C The higher price level will decrease real wages, prompting demands for wage increases which will shift SRAS left.
D The decrease in unemployment will lead to a permanent change in the full employment level which will shift LRAS to Y1.
E The expansionary fiscal policy will cause crowding out, which will eventually shift aggregate demand back to AD.

10. Which of the following would be counted as part of M2?

I. Checkable Deposits II. Currency
III. Savings accounts IV. Small Time deposits

A. I, II, III, and IV
B. I only
C. II only
D. I, II only
E. I, II, III only.

11. An increase in the money supply is most likely to have which of the following short-run effects on real interest rates and real output?

	Real Interest Rates	Real Output
A	Decrease	Decrease
B	Decrease	Increase
C	Increase	Decrease
D	Increase	No Change
E	No Change	Increase

12. An expansionary monetary policy will lead to

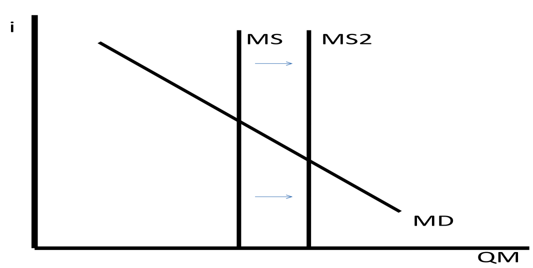
	Real GDP	Price Level	interest rates
A	uncertain	uncertain	decrease
B	increase	decrease	uncertain
C	decrease	decrease	decrease
D	increase	increase	uncertain
E	decrease	decrease	increase

13. If the money supply decreases but nominal GDP remains constant, which of the following has MOST LIKELY occurred?
A. velocity of money has increased
B. velocity of money has decreased
C. price level has increased
D. real output has increased
E. real output has decreased

14. Which of the following best explains how an economy could simultaneously experience high inflation and high unemployment?
A. the government increases spending without increasing taxes
B. the government increases taxes without increasing spending
C. inflationary expectations decline
D. women and teen-agers stay out of the labor force
E. negative supply shocks cause factor prices to increase

15. Assume $200 is deposited in a banking system that requires banks to reserve 50% of all deposits. If all money is re-deposited and banks hold no excess reserves, the TOTAL change in the money supply, including the initial deposit, will be
A $200
B $50
C $2
D $400
E $800

For 16 use the following graph



16. Which Federal Reserve Bank action would cause the shift seen in the graph?
A. an increase in the discount rate
B. a budget deficit leading to increased government borrowing
C. selling of government bonds
D. a decrease in the reserve requirement
E. a decrease in the nominal interest rate

17. In order to execute monetary policy quickly and easily, the FED prefers operating under a money demand line that is
A Relatively elastic
B Relatively inelastic
C Perfectly elastic
D Upward sloping
E Perfectly inelastic

18. A government facing a $400 billion gap in equilibrium and an MPC of .5 needs to increase spending by how much?
A 400 billion
B 100 billion
C 50 billion
D 200 billion
E 2 billion

19. If the economy is operating in the intermediate range of the aggregate supply curve and if aggregate demand increases due to an increase in net exports, then the price level, output, and unemployment rate are most likely to change in which of the following ways?

	Price Level	Output	Unemployment Rate
A.	Increase	Increase	Increase
B.	Increase	Increase	Decrease
C.	Increase	Decrease	Increase
D.	Increase	Decrease	Decrease
E.	Decrease	Decrease	Increase

20. Which of the following would INCREASE the supply of loanable funds?
A Decrease in long term mortgage rates
B Withdrawals of funds by bank customers
C Consumer purchases of treasury securities
D Federal reserve purchases of treasury securities
E New bonds issued by the Treasury department

21. The money creating ability of the banking system will be less than the maximum amount indicated by the multiplier when
A. interest rates are high
B. the velocity of money is high
C. people hold a portion of their money in the form of currency
D. the unemployment rate is low
E. the government's budget is in deficit

22. What constitutes the largest component of the United States money supply (M1)?
A. silver certificates
B. checkable deposits
C. currency
D. coins
E. large certificates of deposit

23. Under which of the following conditions would a restrictive (contractionary) monetary policy be most appropriate?
A. high inflation
B. high unemployment
C. full employment with stable prices
D. low interest rates
E. a budget deficit

24. M1 money represents which basic function of money
A Medium of exchange
B Store of value
C Durability
D Open market operations
E Multipliability

25. Which of the following are true statements about the Federal Funds Rate?
I. It is the same thing as the discount rate.
II. It is the interest rate that banks charge each other for short term loans.
III. It can be influenced by open market operations.

A I only
B II only
C III only
D I and II only
E II and III only.

26. The money market is a short-term market directly affected by monetary policy that determines nominal interest rates. How is this different than the loanable funds market?

A The loanable funds market is immune to monetary policy changes.
B The government is the only buyer in the loanable funds market.
C The loanable funds market is long-term and determines real interest rates.
D The Fed's fiscal policies, not monetary policies, drive the loanable funds market.
E The loanable funds market exists inside of the money market.

27. Which statement expresses the relationship between bond prices and monetary policy?

A. Expansionary monetary policy causes bond prices to increase.
B. Expansionary monetary policy caused bond prices to decrease.
C. Contractionary monetary policy causes bond prices to increase.
D. Bond prices serve as a signal of when monetary policy is needed.
E. Monetary policy affects interest rates, not bond prices.

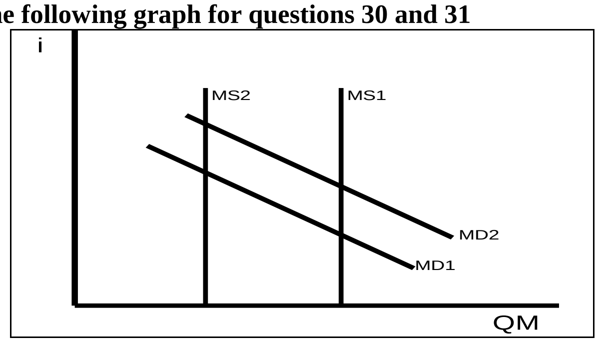
28. In the short run, a restrictive (contractionary) fiscal policy will cause aggregate demand, output, and the price level to change in which of the following ways?

	Aggregate Demand	Output	Price Level
A.	Decrease	Decrease	Decrease
B.	Decrease	Increase	Increase
C.	Increase	Decrease	Decrease
D.	Increase	Increase	Increase
E.	Not change	Not change	Not change

29. One way in which the Federal Reserve regularly works to change the United States money supply is by changing the

A. number of banks in operation
B. velocity of money
C. price level
D. prime rate
E. discount rate

Use the following graph for questions 30 and 31



30. The shift from MS1 to MS2 would have been caused by

A an increase in the amount of money people wanted to keep in interest bearing accounts.
B an increase in the discount rate.
C an open market purchase of bonds.
D a decrease in the amount of money people needed for transactions.
E a decrease in the reserve requirement.

31. The shift from MD1 to MD2 would have been caused by

A an increase in consumer confidence and the desire to spend.
B an increase in the discount rate.
C an open market purchase of bonds.
D a decrease in the amount of money people needed for transactions.
E a decrease in the reserve requirement.

32. Anticipated inflation is 4%. Banks expect a real return of 3% on loans. Based on this information, what is the nominal interest rate likely to be?

A 1%
B 10%
C .75%
D 7%
E 12%

33. Policymakers concerned about fostering long-run growth in an economy that is currently in a recession would most likely recommend which of the following combinations of monetary and fiscal policy?

	Monetary Policy	Fiscal Policy
A.	Sell Bonds	Reduce Taxes
B.	Sell Bonds	Raise Taxes
C.	No change	Raise taxes
D.	Buy bonds	Reduce spending
E.	Buy bonds	No change

34. According to the Fisher Equation, to find the real interest rate a person simply needs to

A subtract the inflation rate from the nominal interest rate.
B add the nominal interest rate to the inflation rate.
C multiply the money supply times velocity.
D divide the number one by the reserve requirement.
E subtract the marginal propensity to save from the inflation rate.

35. Assuming MV = PQ where V is constant, an increase in the money supply will DEFINITELY have which effect in the long run?

A It will cause a decrease in real output.
B There will be a rightward shift in the long run aggregate supply curve.
C The price level will decrease.
D Nominal GDP will increase.
E There is not enough information to predict long run results.

36. If the legal reserve requirement is 25%, the value of the money multiplier is

A. 2
B. 4
C. 5
D. 10
E. 1.0

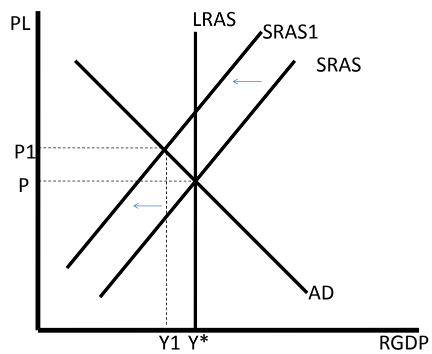
37. Assuming no other policy is enacted, which of the following correctly describes the linkage between a change in monetary policy and a shift in aggregate demand?

A Monetary policy will change the money supply, changing interest rates, which will cause the government spending to change, shifting aggregate demand.
B Monetary policy will change the tax rates, which will change disposable income, which will change consumption and investment, which will shift aggregate demand.
C Monetary policy will change the money supply, which will change interest rates, which will change investment and consumption, which will shift aggregate demand.
D Monetary policy can not change aggregate demand, only aggregate supply.
E Monetary policy does not need a linkage system. It has an automatic impact on aggregate demand.

38. One of the primary arguments against classical theory is
I. Prices are sticky, therefore the economy can not effectively correct itself in the short run.
II. Wages are sticky, therefore the economy can not effectively correct itself in the short run.
III. People do not re-deposit all their money in the bank, therefore monetary policy is not always effective.
IV. Lags prevent the economy from correcting itself in the long run.

A I and IV only.
B I and III only.
C I, II, III only.
D I and II only
E II only.

Use the following graph to answer question 39.



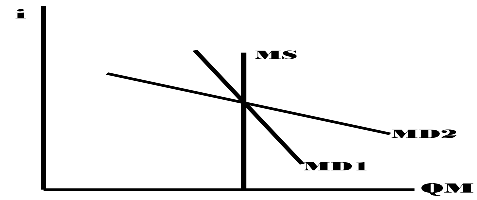
39. Expansionary monetary policy may be discouraged in the situation above because it would
A shift LRAS left over a period of time.
B cause the unemployment level to increase.
C generate higher price levels in an already inflationary situation.
D alter existing policies from the government leading to the current situation.
E further decrease SRAS causing higher prices and more unemployment.

40. Expansionary monetary policy results in which of the following in the short run?
I. The money supply increases.
II. The nominal interest rate decreases.
III. The real interest rate decreases.
IV. Bond prices Decrease.

A I and II only
B I, II, and III only
C I, II, and IV only
D III and IV only
E IV only

41. Some critics of Monetary Policy complain about the "neutrality" of money. Which fact could they use to support their argument?
A velocity is more important than the supply of money
B people and businesses do not respond predictably to interest rate changes
C the amount of money in the economy has no direct effect on Aggregate Demand
D increasing the money supply often leads to crowding out of private investment
E the Fed has no tools that are effective at manipulating the lending activities of the economy

Use the graph below for question 42.



42. If the Fed wishes to implement an expansionary monetary policy, which Money Demand curve is more desirable if they are trying to keep inflation as low as possible?
A. MD1
B. MD2
C. MD3
D. The slope of the MD line doesn't matter because the FED changes money supply.
E. The Fed can change the MD line to whatever they want it to be.

43. When consumers hold money rather than securities because they desire to make new purchases, they are holding money for which purpose?
A. transactions
B. unforeseen expenditures
C. speculation
D. illiquidity
E. exchange

44. Assume that in the past 6 months the Fed has bought bonds and drastically reduced the discount rate. *Ceteris paribus*, bank to bank lending should be increasing because the
A consumer price index will be lower.
B real interest rates will be higher, allowing for greater profits
C inflation rate will be decreasing.
D money supply is tighter and people demand more money.
E federal funds rate will likely be lower.

45. In small town X there are only two banks within reasonable driving distance. Bank 1 announces it is purchasing Bank 2. Which statement is now true?
A. Bank 1 has increased its assets and decreased its liabilities.
B. M1 has increased, M2 has decreased.
C. Bank 2 no longer has any liabilities.
D. Bank 1 has increased its assets and increased its liabilities.
E. Bank 1 has decreased its liabilities and increased its assets.

46. Assuming normal inflation patterns, in the long run, how are nominal and real interest rates related?

	NOMINAL	REAL
A	**Increase**	**Decrease**
B	**Constant**	**Decrease**
C	**Increase**	**Constant**
D	**Constant**	**Constant**
E	**Decrease**	**Increase**

47. Economic growth can be shown by which of the following?
I Increase in Real GDP
II. Increase in Real GDP Per Capita
III. Rightward shift of LRAS

A I only
B II only
C I and II only
D I, II, and III
E I and III only